

## Overview of Declaration

9. I explain these central conclusions more fully as follows. Section 2 explains why forbearance from the unbundling provisions of the Act is appropriate only when an ILEC would be unable to exercise market power if reasonably efficient CLECs were denied access to UNEs at regulated (TELRIC) rates. Section 3 reviews the central elements of the standard test for market power, including the identification of relevant product markets, relevant geographic markets, and likely market participants. Section 4 considers the ability of one important group of market participants – CLECs – to constrain ILEC market power.

10. Section 5 explains why the “reasonably efficient competitor” standard is the proper standard in formulating forbearance decisions. Section 6 reviews the benefits of timely forbearance and the costs of premature forbearance, and recommends a careful balancing of these benefits and costs. Section 7 explains why such a balancing reveals forbearance in Anchorage presently is contrary to the public interest. Section 8 reviews some of the many fallacies in ACS’ appeal for forbearance. Section 9 concludes this declaration.

### **2. Forbearance from Unbundling is Appropriate Only in the Absence of ILEC Market Power, Including an Inability to Increase Price by Raising Rivals’ Costs.**

11. The Federal Communications Commission (“the Commission”) has determined that facilities-based CLECs generally would be impaired without access to DS-0 loops in all circumstances and to DS-1 loops in circumstances where sufficient alternative competitive supply is not available. [*TRO*, ¶¶146, 149, 179]<sup>6</sup> However, the Commission observes that “incumbent LECs remain free to seek forbearance from the application of our unbundling rules in specific geographic markets where they believe the aims of Section 251(c)(3) have been “fully implemented” and the other requirements for forbearance have been met.” [*TRO Remand*, ¶39]<sup>7</sup>

12. Section 10(a) of the Act directs the Commission to “forbear from applying any regulation or provision of this Act ... if the Commission determines that – (1) enforcement of such regulation or provision is not necessary to ensure ... just and reasonable [outcomes] ...; (2)

---

<sup>6</sup> *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Dockets Nos. 01-338, 96-98, 98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, 17145 (2003).

<sup>7</sup> *In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533 (2005).

## REDACTED FOR PUBLIC INSPECTION

enforcement of such regulation or provision is not necessary for the protection of consumers; and (3) forbearance from applying such provision or regulation is consistent with the public interest.”

In evaluating the effect of forbearance on the public interest, Section 10(b) requires the Commission to consider whether forbearance would “promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services.” Section 10(d) of the Act states that the “Commission may not forbear from applying the requirements of Section 251(c) ... until it determines that those requirements have been fully implemented.” All these requirements must be satisfied in order for an ILEC to obtain the forbearance from unbundling obligations that ACS presently seeks in Anchorage.

13. These directives imply forbearance from the Section 251(c)(3) unbundling obligations (“forbearance”) is appropriate when – and only when – the competition that can reasonably be expected in the absence of mandated access to UNEs at regulated (TELRIC) prices will protect consumers by precluding the exercise of ILEC market power. The Act mandated access to UNEs at regulated prices to ensure that competition could thrive in the absence of alternative sources of essential network functionality (e.g., loop transmission).<sup>8</sup> Given the Act’s intention to replace retail rate regulation with competition, the competition that will prevail under forbearance must protect consumers against unjust and unreasonable prices in the absence of retail rate regulation. Consumers will be so protected only when ILEC market power has been eliminated. Therefore, to determine whether forbearance is appropriate in any relevant market, it is necessary to determine whether the ILEC will have market power in that market if CLECs are denied access to UNEs at regulated rates.

14. An ILEC has market power when it is able to profitably “maintain prices above competitive levels for a significant period of time.” [*DOJ Guidelines*, §0.1]<sup>9</sup> In competitive markets, prices reflect the costs of efficient suppliers. In the telecommunications industry,

---

<sup>8</sup> The Joint Explanatory Statement of the Committee of Conference that accompanied the Conference Report specifically states “This conference agreement recognizes that it is unlikely that competitors will have a fully redundant network in place when they initially offer local service, because the investment necessary is so significant. Some facilities and capabilities . . . will likely need to be obtained from the incumbent local exchange carrier as network elements pursuant to new section 251.” S. Rep. 104-458 at 148.

<sup>9</sup> *Horizontal Merger Guidelines*. U. S. Department of Justice and the Federal Trade Commission. Washington, D.C. Revised April 8, 1997.

relevant costs include the costs of key inputs (e.g., loops, transport, and switches) and the costs of combining these key inputs to produce outputs such as local exchange and exchange access service. Therefore, “prices above competitive levels” refer to prices that exceed these costs of an efficient supplier by a modest amount (often in the neighborhood of five percent).<sup>10</sup>

15. The “significant period of time” in which an ILEC can sustain prices above competitive levels is the period in which consumers are harmed by the exercise of monopoly power. The Act did not call for consumers to be harmed for any sustained period of time as local exchange competition develops. Therefore, for the purposes of analyzing forbearance from Section 251(c), it is reasonable to presume an ILEC has market power if it would be able to sustain supra-competitive prices for any appreciable time period (e.g., several months).

16. Forbearance that leaves an ILEC with market power does not satisfy the relevant prerequisites for forbearance. Such forbearance does not: (1) ensure just and reasonable wholesale and retail rates; (2) protect customers against the exercise of market power; or (3) promote competitive market conditions. Importantly, these harms can arise from market power that the ILEC derives from its dominant control over key inputs (e.g., loops). This wholesale market power can persist and can continue to harm consumers even in the presence of intense retail competition.

17. To illustrate this important conclusion, recall that if an ILEC faced no meaningful retail competition and no retail price regulation, it could exploit consumers directly by charging the monopoly price for the service it supplies to retail customers. Under forbearance, an ILEC with dominant control of key inputs (UNEs) can achieve this same detrimental outcome even when it faces intense retail competition from UNE-based CLECs. The ILEC can do so by raising the prices of UNEs to the point where CLECs can only serve customers profitably if they charge the monopoly price for the retail service. The high UNE prices under such a policy preclude any (supracompetitive) profit for CLECs, but generate the full monopoly profit by forcing retail customers to pay the monopoly price. The ILEC collects this profit in the form of high wholesale profit. The ILEC will be indifferent as to whether it collects the monopoly profit via its retail or

---

<sup>10</sup> In defining relevant product markets, the *DOJ Guidelines* (§1.11) state “In attempting to determine objectively the effect of a “small but significant ...” increase in price, the Agency, in most contexts, will use a price increase of five percent ...”.

*its wholesale operations, as long as it secures the monopoly profit.*<sup>11</sup> Consumers are similarly indifferent as to whether they are exploited by an ILEC with a monopoly retail operation or an ILEC that compels CLECs to charge monopoly retail prices by saddling them with high UNE prices. Consumers suffer equal (and substantial) harm under both arrangements.

18. To illustrate this well-known and widely-accepted principle with a simple example, suppose each unit of retail service (e.g., local exchange access) requires one UNE (e.g., a loop) and one unit of another input (e.g., switching). Let each UNE cost the ILEC \$15 to produce. (UNE substitutes are assumed to be prohibitively costly for a CLEC to produce.) Also let each unit of the other input cost an efficient supplier \$5 to produce. In addition, suppose each of 1,000 potential customers is willing to pay as much as \$50 for one unit of the retail service.

19. If the ILEC were the sole supplier of both inputs and it operated efficiently, the ILEC could produce the retail service at a unit cost of \$20 ( $= \$15 + \$5$ ). If it faced no retail competitors, the ILEC could charge each customer the (monopoly) price of \$50, thereby securing a profit margin of \$30 ( $= \$50 - \$20$ ) on each unit of the retail service sold. The ILEC's total profit would be \$30,000 ( $= \$30 \times 1,000$  customers).

20. Suppose instead an efficient CLEC served all retail customers. An ILEC that had successfully achieved forbearance could charge the CLEC \$45 for each UNE. By doing so, the ILEC would raise the unit cost of the efficient CLEC to \$50 ( $= \$45 + \$5$ ). The CLEC could only operate profitably under these circumstances by charging consumers the most they are willing to pay for the service, \$50. The CLEC earns no (supracompetitive) profit in this setting. In contrast, despite losing its entire retail market share, the ILEC secures \$30,000 in profit from its wholesale operations. This profit is the product of the ILEC's profit margin on each UNE sold to the CLEC ( $\$30 = \$45 - \$15$ ) and the 1,000 UNEs sold to the CLEC (to supply the 1,000 retail customers).

21. Although this example is simple, it is not pathological. In this example and more generally, consumers will not be protected against unjust and unreasonable prices whether they face an unregulated ILEC that is a dominant supplier of retail services or they purchase retail services from efficient CLECs that are forced to purchase UNEs from an ILEC that is a dominant

---

<sup>11</sup> This conclusion is a variant of what is commonly referred to as the "one monopoly rent" theorem. The theorem states that under certain conditions "a monopolist at any single level of a distribution chain can recover all monopoly profit available in that chain. As a result a monopolist of two successive links will not make more monopoly profits than a monopolist of only one" (Hovenkamp, 1985, p. 150).

## REDACTED FOR PUBLIC INSPECTION

supplier of UNEs. Thus, even intense retail competition will fail to protect consumers when CLECs face an ILEC with dominant control of one or more key inputs.<sup>12</sup> This control will allow the ILEC to raise retail prices above competitive levels by raising the costs of its retail rivals.

22. These conclusions reflect both well-known and widely-accepted economic principles and long-standing Commission recognition of the ability of a vertically-integrated ILEC to exercise the market power it derives from its wholesale operations to harm retail customers.<sup>13</sup> The Commission has noted, for example, that “A carrier may be able to unilaterally raise prices by increasing its rivals’ costs or by restricting its’ rivals’ output through the carrier’s control of an essential input, such as access to bottleneck facilities, which its rivals need to offer their services.”<sup>14</sup> Similarly, the Commission has observed that “A carrier can raise prices profitably and sustain them above competitive levels, and thereby exercise market power, ... by increasing its rivals’ costs or restricting its rivals’ output through the control of an input that is necessary for the provision of service.”<sup>15</sup> In addition, the Commission has warned that “In the absence of

---

<sup>12</sup> Therefore, as explained further in section 8, ACS’ characterization of the Anchorage study area as “among the most competitive telecommunications markets in the country” based on retail market shares fails to address the central issue of ACS’ wholesale market power. *Petition of ACS of Anchorage, Inc. for Forbearance from Sections 251(c)(3) and 252(d)(1)*, WC Docket No. 05-281, September 30, 2005 [ACS Petition], p. 1.

<sup>13</sup> These principles are established in Salop and Scheffman (1983, 1987), Salop et al. (1984), Krattenmaker and Salop (1986), and Krattenmaker et al. (1987), among others. The courts also routinely employ these principles. See, for example, *Premier Electrical Construction Co. v. National Electrical Contractors Association, Inc.*, 814 F.2d 358; 1987 U.S. App, and *Mary Forsyth et al. v. Humana, Inc.*, 114 F.3d 1467; 1997 U.S. App.

<sup>14</sup> *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission’s Rules*, WC Docket No. 02-112; CC Docket No. 00-175, 18 FCC Rcd 10914 (2003), ¶5, n. 10.

<sup>15</sup> *Rules and Policies on Foreign Participation in the U.S. Telecommunications Market; Market Entry and Regulation of Foreign-Affiliated Entities*, IB Docket No. 97-142; IB Docket No. 95-22, 12 FCC Rcd 23891 (1997) [Foreign Participation Order], ¶144. The Commission also has noted that “Firms with market power in an “upstream” input market can engage in discrimination in a “downstream” end-user market by favoring one downstream entity at the expense of its competitors. When the upstream firm possesses market power, the downstream competitors have few, if any, alternative sources for the upstream input. We find that the relevant input markets ... generally include ... local access facilities ...” [Foreign Participation Order, ¶146] The Commission identifies “price discrimination, non-price discrimination, and price squeeze behavior” as “three anticompetitive strategies” a vertically-integrated ILEC with market power could employ to “cause harm to competition ...” [Foreign Participation Order, ¶146] Thus, an ILEC with dominant control over key inputs can employ many anticompetitive policies (not just the one illustrated here) to raise its rivals’ costs and thereby harm retail customers.

## REDACTED FOR PUBLIC INSPECTION

UNEs, incumbent LECs would ... have the ability to set the price of their direct competitors' critical wholesale inputs. ... An incumbent in that situation would have substantial incentive to raise prices to levels close to or equal to the associated retail rate, creating a "price squeeze" and foreclosing competition based on use of the tariffed wholesale input."<sup>16</sup> [*TRO Remand*, ¶59]

23. These well-known principles and well-established Commission policy provide an important conclusion: To determine whether forbearance is appropriate, it is necessary to determine if ILECs will be able to exercise market power (by raising their rivals' costs, for example) if CLECs are denied access to UNEs at regulated rates.

### 3. The Test for ILEC Market Power.

24. The *DOJ Guidelines* provide a systematic and widely accepted means for assessing likely market power. The *DOJ Guidelines* identify four important steps in determining whether an ILEC (or any other firm) will possess market power in the setting of interest: (1) identify the relevant product market(s); (2) identify the relevant geographic market(s); (3) determine the likely market participants; and (4) assess the ability of the likely market participants to drive prices to competitive levels in the relevant product and geographic markets.<sup>17</sup>

#### A. The Relevant Product Market(s).

25. Intuitively, a product market consists of all products "that consumers consider reasonably interchangeable for the same purposes." [*United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 395 (1956)] More formally, a product market is "a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ... likely would impose at least a "small but significant and nontransitory" increase in price." [*DOJ Guidelines*, §1.11]

---

<sup>16</sup> Notice that under forbearance, an ILEC with wholesale market power can employ a price squeeze to its advantage (and to the disadvantage of CLECs and consumers alike) even when retail prices are regulated. The ILEC can raise UNE rates to the point where even the most efficient CLEC cannot profitably serve the customers that the ILEC finds profitable to serve at regulated retail rates. Although such a price squeeze does not increase retail prices above regulated levels, it prevents customers from enjoying the lower prices that competition would secure if CLECs could obtain UNEs at competitive rates.

<sup>17</sup> Similarly, the Commission determines whether a carrier is dominant (and so has market power) by: "(1) delineating the relevant product and geographic markets for examination of market power; (2) identifying firms that are current or potential suppliers in that market; and (3) determining whether the carrier under evaluation possesses individual market power in that market." [*Omaha Decision*, ¶18]

**REDACTED FOR PUBLIC INSPECTION**

26. A key group of products that ILECs and CLECs deliver to customers is retail wireline local exchange and exchange access service, which enables customers to initiate and receive telephone calls. Because consumers typically perceive few suitable alternatives for the service, a monopoly supplier of the service would find it profitable to raise the price of the service above competitive levels. (Indeed, this is the reason for widespread historic regulation of the price of local exchange service.) Consequently, wireline local exchange and exchange access service is a candidate for one or more relevant product markets. A related, but separate product market is the market for bundled local and long distance services.<sup>18</sup>

27. Competition may drive prices to competitive levels for some groups of customers, but not for others. Therefore, in defining product markets it is important to distinguish among groups of customers that face different intensities of competition or that exhibit different purchasing patterns and/or different patterns or intensities of product use.

28. In its merger and impairment analyses, the Commission routinely distinguishes among: (1) residential customers; (2) small business customers, (3) medium enterprise customers; and (4) large enterprise customers.<sup>19</sup> The Commission has specifically noted that “the economic characteristics of the mass market, small and medium enterprise, and large enterprise customer classes can be sufficiently different that they constitute major market segments,” explaining that “These customer classes generally differ in the kinds of services they purchase, the service quality they expect, the prices they are willing to pay, the levels of revenue they generate, and

---

<sup>18</sup> See *SBC Communications, Inc. and AT&T Corp. for Approval of Transfer of Control*, Memorandum Opinion and Order, WC Docket No. 05-65, Released November 17, 2005 [*SBC-AT&T Order*], ¶95] and *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, WC Docket 05-75, Released November 17, 2005 [*Verizon-MCI Order*] ¶96.

<sup>19</sup> See, for example, [*TRO*, ¶123]. Also see the merger orders cited in [*TRO*, ¶126]. For example, the Commission observes “Within a product market it is possible to identify and aggregate consumers with similar demand patterns. We conclude there are at least three customer groups that can be identified as having similar patterns of demand: (1) residential customers and small businesses; 2) medium-sized businesses; and 3) large businesses/government users. Each of these customer groups exhibits distinct buying patterns.” *Application of NYNEX Corp., Transferor, and Bell Atlantic Corp., Transferee, For Consent to Transfer Control of NYNEX Corp. and Its Subsidiaries*, File No. NSD-L-96-10, Memorandum Opinion and Order, 12 FCC Rcd 19985, 20016 (1997) [*NYNEX-Bell Atlantic Order*], ¶53. This approach is also consistent with the Commission’s distinction between “the mass market (residential consumers and small business customers) and the enterprise market (medium-sized and large business customers)” in *Omaha* [*Omaha Decision*, ¶22] and with the Commission’s conclusion that “small enterprise customers fall into a different relevant product market from mid-sized to large retail enterprise customers.” [*SBC-AT&T Order*, ¶60] and [*Verizon-MCI Order*, ¶60]

**REDACTED FOR PUBLIC INSPECTION**

the costs of delivering them services of the desired quality.” [TRO, ¶123] In her declaration, Ms. Gina Borland attests that residential consumers and the smallest businesses are in a different product market than larger businesses. The services that are appropriate for a residential consumer or a SOHO business typically are not appropriate, and do not substitute for, the services provided to small, medium, and large businesses.

29. More granular distinctions among customer groups also can be appropriate. As the Department of Justice Guidelines make clear, the product market should generally be the “smallest group of products that satisfies” the test of a small, but significant and non-transitory price increase.<sup>20</sup> For example, the costs of serving residential customers can vary significantly for a CLEC like GCI according to whether the customer resides in a multiple-dwelling unit (“MDU”). For the reasons explained in the Declarations of Blaine Brown and Gary Haynes, cost, technical, and operational issues all can limit a carrier’s ability to deliver cable telephony to customers who live in MDUs.<sup>21</sup> Consequently, residential customers who reside in MDUs in Anchorage may well face different intensities of competition than residential customers who live in single-family homes. Thus, a relevant service sold to customers in MDUs may appropriately be considered as a separate product market from the same service sold to other residential consumers.

30. Likewise in the business market, different network segments (e.g., loops and transport) can constitute separate product markets, as can different capacities of service.<sup>22</sup> Furthermore, as the Commission has noted, “differences in performance, reliability, security and price” can be sufficiently pronounced so as to define different product markets.<sup>23</sup> This is the case in the business market in Anchorage. As explained in the Declaration of Gary Haynes, the services required by some medium business customers (e.g., non-Internet private line services such as ISDN-PRI and DSS services) can only be provided over high capacity fiber networks or copper-

---

<sup>20</sup> [DOJ Guidelines, § 1.11].

<sup>21</sup> As explained in the Declarations of Gary Haynes, the problems become particularly severe in MDUs with more than eight switched lines.

<sup>22</sup> [SBC-AT&T Order, ¶27 and n. 90] and [Verizon-MCI Order, ¶27 and n. 89] (finding special access channel terminations and transport to be in separate product markets, and noting that “different capacity circuits are likely to constitute separate relevant product markets.”)

<sup>23</sup> [SBC-AT&T Order, ¶26]. See also [SBC-AT&T Order, ¶58] and [Verizon-MCI Order, ¶58] (finding that “local voice, long distance voice, and data services constitute distinct product markets” for enterprise customers).

loop networks with more traditional architectures. Industry literature also supports viewing DS1-based services as a distinct product market from both fiber-based services and the mass market services typically available over a DOCSIS cable telephony network.<sup>24</sup>

31. In summary, it is reasonable to view local exchange and exchange access services in Anchorage as comprising at least three relevant product markets. These product markets are the wireline local exchange and exchange access services sold to: (1) residential customers; (2) small business customers; and (3) medium and large enterprise customers. Further disaggregation (to distinguish between medium and large enterprises, such as enterprises requiring DS3 and greater capacity services, and between MDU and non-MDU residential customers, for example) also may be appropriate.

**B. The Relevant Geographic Market(s).**

32. Just as competitive pressures can vary for different customer groups, the pressures can vary across geographic regions. Therefore, in assessing whether competition will drive prices to competitive levels, it is important to identify the geographic region in which competitive pressures are being examined.

33. Intuitively, a relevant geographic market is the "area in which customers can reasonably search for competing services." [*Sprint-Nextel Order*, ¶52]<sup>25</sup> More formally, a relevant geographic region is "a region such that a hypothetical monopolist that was the only present and future producer of the relevant product at locations in that region would profitably impose at least a "small and nontransitory" increase in price, holding constant the terms of sale for all products produced elsewhere." [*DOJ Guidelines*, §1.21]

34. The relevant geographic market for wireline local exchange and exchange access service generally consists of the location at which the service is secured. Wireline local exchange and exchange access service at some location other than where the service is normally employed to initiate and receive telephone calls generally is not a reasonable substitute for the same service at

---

<sup>24</sup> See Scientific Atlanta, *MSO Commercial Services Development: Scientific Atlanta's Position on the Significance of Commercial Services and the Critical Success Factors for MSOs*, September 2003, for example.

<sup>25</sup> *Applications of Nextel Communications, Inc. and Sprint Corporation For Consent to Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, WT Docket No. 05-63, Released August 8, 2005.

## REDACTED FOR PUBLIC INSPECTION

a different location.<sup>26</sup> Consequently, a hypothetical monopoly supplier of wireline local exchange and exchange access service at a given location typically would find it profitable to increase price above the competitive price level. Therefore, the relevant geographic market for wireline local exchange and exchange access service is the location at which the service is secured.

35. For the purpose of analysis, it is reasonable to treat as a single geographic market the separate geographic markets in which “all customers in [each of those markets] will likely face the same competitive alternatives” for the product in question. [NYNEX-Bell Atlantic Order, ¶51]<sup>27</sup> The presence of similar competitive alternatives typically implies the presence of similar pressures to reduce prices to competitive levels. Potential indicators of similar competitive alternatives include similar numbers of competitors with similar technologies and operating costs.

36. These observations imply that the entire ACS Anchorage study area is not the relevant geographic market in the present proceeding.<sup>28</sup> Competitive conditions vary considerably in different regions of Anchorage, even within individual ACS wire centers, for at least three reasons. First, GCI’s cable plant – on which ACS principally relies in making its case for forbearance – is not present throughout the ACS study area. Indeed, GCI’s certificated LEC service area, which is coextensive with ACS’ study area, is larger than GCI’s certificated cable service area. For example, GCI is not the certificated cable provider in Girdwood, which receives cable service from Eyecom, an affiliate of another Alaska ILEC. [Declaration of Gina Borland] Second, GCI’s network and cable nodes have been upgraded as necessary to provide voice service and necessary back-up power in some parts of Anchorage but not in other parts. [Declaration of Gary Haynes] Third, GCI’s cable and fiber networks are not ubiquitous. Consequently, although some businesses in Anchorage are relatively close to the relevant GCI network, others are quite far from the relevant GCI network.

<sup>26</sup> [SBC-AT&T Order, ¶¶ 28 (special access), 62 (enterprise customers), 97 (mass market)] and [Verizon-MCI Order, ¶¶ 28 (special access), 62 (enterprise customers), 98 (mass market)].

<sup>27</sup> The Commission notes that “while each point to point local calling route constitutes a separate market, the fact that each customer faces the same competitive alternatives for each route allows us to aggregate these routes into a service called local exchange and exchange access service.” [NYNEX-Bell Atlantic Order, ¶51]

<sup>28</sup> Thus, as explained in more detail in section 8, ACS’ claim that “The Anchorage LEC Study Area is the appropriate geographic market” is not supported by the facts in this case. [ACS Petition, p. 27]

## REDACTED FOR PUBLIC INSPECTION

37. Because ACS wire centers and the regions in which GCI has upgraded its cable nodes have distinct boundaries,<sup>29</sup> competitive conditions vary both across and within wire centers in Anchorage. Notice, for example, that GCI currently serves just **[BEGIN CONFIDENTIAL][END CONFIDENTIAL]** of its residential customers in ACS' East wire center using its own facilities exclusively.<sup>30</sup> In contrast, GCI currently employs UNEs secured from ACS to serve **[BEGIN CONFIDENTIAL][END CONFIDENTIAL]** of its residential customers in the O'Malley and Rabbit Creek wire centers.<sup>31</sup> In regions where GCI presently is able to provide local exchange and exchange access service using only its own facilities, there is at least one alternative market participant (GCI) that could, in principle, help to limit ACS' market power even if CLECs were denied access to UNEs at regulated rates (provided customers are not too distant from the cable facilities and are not concentrated in MDUs, for example). In other regions, where CLECs cannot presently provide local exchange and exchange access service economically using their own facilities exclusively, there are no alternative facilities that can be employed to help to limit ACS' wholesale market power.<sup>32</sup>

38. An appropriate delineation of relevant geographic markets should aggregate together only those customer locations that have similar competitive alternatives to ACS facilities. Areas that are distant from fiber or cable facilities should not be included in the same geographic market as areas that are close to the relevant facilities. Similarly, residential and small business locations passed by cable plant with upgraded nodes should not be included in the same geographic market as corresponding locations that are not so passed.

39. The Commission has noted that it can sometimes be reasonable to employ an ILEC's wire centers as proxies for relevant geographic markets in order to avoid the need for CLECs to inform ILECs of the details of their full facilities-based operation on an ongoing basis. [*Omaha*

---

<sup>29</sup> See the Declaration of Gina Borland.

<sup>30</sup> See the Declaration of William Zarakas.

<sup>31</sup> *Id.*

<sup>32</sup> The Commission has recognized that "carriers face substantial fixed and sunk costs, as well as operational barriers, when deploying loops, particularly where the capacity demanded is relatively limited. Given these barriers, it appears unlikely that a carrier would be unwilling to make the significant sunk investment without some assurance that it would be able to generate revenues sufficient to cover that investment. ... Moreover, even when there is adequate retail demand, the costs of constructing the loop may be sufficiently high, or there may be other operational barriers, that may deter entry." [*SBC-AT&T Order*, ¶39] and [*Verizon-MCI Order*, ¶39]

*Decision*, ¶69, n. 186] Before instituting forbearance in a particular wire center, though, it is important to verify that reasonably efficient competitors will be able to serve the vast majority of customers in the wire center economically within a commercially reasonable period of time. Otherwise, a substantial number of customers will be exposed to largely unconstrained ILEC market power for a considerable period of time, which is inconsistent with the goals and mandates of the Act.

### C. The Relevant Market Participants.

40. After identifying relevant product and geographic markets, it is important to identify likely participants in those markets. It is generally reasonable to assume the ILEC that presently operates in a given geographic market will continue to operate in the market if regulated access to UNEs is precluded. The critical questions for assessing an ILEC's market power under forbearance from Sections 251(c)(3) unbundling obligations are: (1) Will CLECs participate in the relevant market if they are denied access to UNEs at regulated rates ("regulated UNE access")? and (2) Will participating CLECs be able to impose the discipline required to ensure prices that reflect the costs of efficient suppliers in the relevant market?

41. CLECs can reasonably be expected to operate in a market without regulated UNE access if such operation would be economic (i.e., if the CLECs would not be impaired without regulated UNE access). Operation is economic when (the present discounted value of) revenues from operation exceed (the present discounted value of) corresponding costs. These costs, in turn, typically include entry barriers, which can sometimes be prohibitive.<sup>33</sup> When CLECs are denied access to UNEs, the entry barriers they commonly face include: (a) high costs of securing access to public rights of way; (b) high costs of securing building access when customers reside in multiple-dwelling units; (c) high costs of deploying cable plant to permit high-quality voice telephony; and (d) high costs of securing key inputs from wholesale suppliers.

42. The costs CLECs experience in implementing full facilities-based operation can vary substantially according to the speed with which such operation is implemented. A CLEC's costs can escalate rapidly if the CLEC is required to transition to full facilities-based operation in a very short period of time (assuming that such an accelerated transition is even feasible from an operational perspective). The higher costs of rapid self-provisioning include: (1) higher labor

<sup>33</sup> As explained further in section 8, ACS' claim that "There are no barriers to entry in the Anchorage wholesale market" is incorrect. [*ACS Petition*, p. 35]

costs due to the need to pay overtime wage rates and the need to offer higher base wages to attract an expanded staff of qualified workers; (2) higher training costs due to the likely shortages of experienced personnel;<sup>34</sup> (3) higher financing costs, because lenders and investors typically demand premiums when asked to supply large amounts of capital; (4) higher costs of procuring inputs that embody new technologies, in part because manufacturers do not yet enjoy the scale economies that arise when the inputs are produced in greater quantities; (5) higher unit costs for other inputs due to the need to procure essential equipment from more distant and higher-cost suppliers; and (6) higher repair and re-installation costs due to the unavoidable errors that arise when less-experienced and/or over-extended personnel work with new and less familiar equipment. In many instances, the costs of rapid self-provisioning can be prohibitive, making such operation either infeasible or uneconomic.<sup>35</sup>

43. The Declaration of Gina Borland reveals that ACS, GCI, and AT&T Alascom are the primary carriers serving the residential, small business, and medium and large business customer groups in Anchorage in the relevant product markets. GCI appears to be the only competitor to ACS that is making substantial use of its own facilities and using UNEs to serve customers. Although other carriers may be certified to operate in Anchorage, the limited number of customers and the presence of GCI and AT&T Alascom make further widespread market participation in Anchorage unlikely, particularly in the near future.

#### **D. The Strength of Competitive Pressures.**

44. After identifying relevant market participants, it is important to assess the ability of competitors to constrain ILEC market power. Like all producers, CLECs cannot profitably serve customers for extended periods of time at prices below their costs of production. The higher are a CLEC's operating costs, the higher is the price it must charge its customers in order to operate profitably. When forbearance forces CLECs to incur high UNE prices, some CLECs may be compelled to terminate their operations altogether, particularly if they are subject to a retail price squeeze by the ILEC. Those that can continue to serve customers will be unable to drive retail prices to competitive levels. Consequently, the ability of CLECs to expand their operations

---

<sup>34</sup> The Commission notes that relevant entry barriers include "operational [barriers] (e.g., lack of skilled workers)." [*Omaha Decision*, ¶35]

<sup>35</sup> See the Declarations of Richard Dowling and Gary Haynes for additional discussions of this important issue.

economically in response to high ILEC prices will be limited, producing a low elasticity of competitive supply to ILEC retail price increases.<sup>36</sup> This important detrimental impact of premature forbearance is reviewed in detail in section 4.

**4. CLEC Inability to Limit ILEC Market Power Under Forbearance.**

45. ACS argues that even if CLECs are unable to operate profitably using their own facilities exclusively, forbearance would not preclude CLEC operation in Anchorage. ACS contends that CLECs would still be able to participate in relevant retail markets either by reselling ACS' services or by employing UNEs acquired from ACS at negotiated rates. [ACS Petition, pp. 35, 43-44] While such participation in retail markets is conceivable, it will not provide the competitive discipline required to eliminate ACS' market power.

46. Consumers are not insulated from the higher costs of inefficient ILEC operation when CLECs simply re-sell an ILEC's services. The resale rates paid by CLECs generally are determined as a percentage of the ILEC's retail rates. Retail rates, in turn, often reflect the incumbent's realized (not efficient) costs. Consequently, increases in an incumbent's costs may simply trigger higher retail rates for consumers. Therefore, resale-based competition is inherently unable to ensure that retail prices will be driven to the level of competitive costs.<sup>37</sup> Resale-based competition also can limit opportunities for innovation and meaningful service differentiation. Consumers are further harmed by this limitation of resale-based competition.<sup>38</sup>

47. Competition using UNEs secured at negotiated rates also is an inadequate substitute for regulated access to UNEs when an ILEC has wholesale market power. Regardless of the intensity of retail market competition, CLECs will be unable to drive retail prices to competitive levels if they are unable to acquire UNEs at rates that reflect the costs of an efficient wholesale

---

<sup>36</sup> The Commission explains that "supply elasticity refers to the ability of suppliers in a given market to increase the quantity of service supplied in response to an increase in price" and notes that supply elasticity will tend to be high when "existing competitors have or can relatively easily acquire significant additional capacity [and in] the absence of significant barriers to entry ..." [Omaha Decision, ¶35]

<sup>37</sup> In part because GCI's operations were primarily UNE-based rather than resale-based, GCI was able to avoid replicating the substantial rate increase that ACS imposed in Anchorage in November 2001. See the Declarations of Dana Tindall and Gina Borland for additional detail.

<sup>38</sup> The Commission has noted that it is difficult for CLECs "to distinguish their resale offering from the offering of the incumbent ILEC on the basis of innovative products or features. Hence, ... the value of a resale option to the creation of competitive markets is diminished." [Omaha Decision, ¶89]

supplier. Absent robust competition among wholesale suppliers of UNEs and absent CLEC ability to self-provision economically, ILECs will have substantial ability to raise UNE rates above the costs of an efficient supplier. *With no economical alternatives to the vital inputs offered by the ILEC, a CLEC that wishes to continue serving its customers will be compelled to pay the high rates demanded by the ILEC.*<sup>39</sup> Consequently, if impaired CLECs are denied regulated access to UNEs, ILECs can employ their wholesale market power to raise the costs of their retail rivals and thereby drive retail prices above competitive levels. Indeed, as illustrated in section 2, even when ILECs face substantial retail competition, they may be able to employ their wholesale market power to force monopoly retail prices.

48. A requirement that UNE rates simply be “just and reasonable” [47 U.S.C. §201(b)] will not ensure that the rates reflect the costs of an efficient wholesale supplier. Under pre-1996 Act regulations, “just and reasonable” rates reflected historical (embedded) costs rather than efficient (forward-looking) costs. Rates based on embedded costs are inferior to rates based on forward-looking costs for at least two reasons. First, rates that reflect embedded costs do not provide strong incentives for efficient operation. When rates increase as costs increase, an ILEC has limited incentive to constrain costs. Consequently, even when UNE rates are “just and reasonable” in the sense that they reflect embedded costs, the rates can exceed the costs of an efficient supplier of UNEs.

49. Second, UNE rates based on embedded costs can reflect substantial common costs. To illustrate, an ILEC might decide to upgrade its loop plant to be better able to deliver high speed data services. Loop rates that include the costs of this upgrade would exceed the costs an efficient supplier would incur to provide basic voice grade telecommunications services. Consequently, CLECs – and ultimately consumers of basic services – would be required to finance the costs of other services if UNE rates simply reflect embedded costs rather than the costs of an efficient supplier of basic telecommunications services.

50. The Commission has noted the drawbacks to rates based on embedded costs and concluded that an “‘embedded cost’-based pricing methodology would be pro-competitor – in this case the incumbent LEC – rather than pro-competition. We therefore decline to adopt embedded cost as the appropriate basis of setting prices for interconnection and access to

---

<sup>39</sup> High UNE rates (and associated high retail rates) can emerge from negotiations between an ILEC and a CLEC even when they have comparable bargaining power (Sappington and Unel, 2005).

## REDACTED FOR PUBLIC INSPECTION

unbundled elements. Rather, we reiterate that the prices for the interconnection and network elements critical to the development of a competitive local exchange should be based on the pro-competition, forward-looking, economic costs of those elements ...” [Local Competition Order, ¶705]<sup>40</sup> The Commission is correct in employing a forward-looking pricing methodology to limit the ability of ILECs to set high UNE rates.

51. To accompany their pronounced ability to impose high UNE rates under forbearance, ILECs would have substantial incentive to charge high UNE rates.<sup>41</sup> This incentive stems from at least four sources. First, a high UNE rate secures high revenue (and thus substantial profit for the ILEC) on each UNE sold to a CLEC. As explained in section 2, ILECs are just as happy to extract monopoly profit from wholesale operations as they are to extract monopoly profit directly from retail customers.<sup>42</sup>

52. Second, as illustrated in section 2, when CLECs are forced to pay high prices for inputs, they will be compelled to set high retail prices. High CLEC prices allow the ILEC to set high retail prices without eroding its customer base, and thereby enjoy greater profit.

53. Third, even if a CLEC ultimately will be able to serve a customer economically using its own facilities exclusively, an ILEC may benefit by instituting high UNE prices that force the CLEC either to raise its prices substantially or to temporarily discontinue service to some of its customers. Customers seldom forgive the CLEC that raises their prices dramatically or discontinues their service. Consequently, an ILEC may acquire a strategic advantage in future

---

<sup>40</sup> Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 15846-50.

<sup>41</sup> Thus, for the reasons discussed in section 8, ACS’ contention that it is likely to voluntarily negotiate reasonable UNE rates with GCI lacks credibility. [ACS Petition, pp. 29, 34]

<sup>42</sup> ACS sought a monthly UNE rate of \$25.88 for a DS-0 loop in recent arbitration. (*In the Matter of the Petition by GCI Communications Corp. d/b/a General Communication, Inc., and/b/a GCI for Arbitration Under Section 252 of the Telecommunications Act of 1996 with the Municipality of Anchorage d/b/a Anchorage Telephone Utility a/k/a ATU Telecommunications for the Purpose of Instituting Local Exchange Competition*, Docket U-96-089, ACS of Anchorage, ACS-ANC and GCI Interconnection Agreement (proposed), Part C, Attachment 1 at 27, filed May 12, 2004) [Anchorage Arbitration Petition] This rate exceeds even ACS’ most recent NECA reported study area monthly average unseparated cost per loop of \$24.62. [Universal Service Fund Data: NECA Study Results, File USF2005LC05.xls in USF05R04.ZIP at <http://www.fcc.gov/wcb/iatd/neca.html>]

## REDACTED FOR PUBLIC INSPECTION

competition with CLECs by forcing the CLECs to raise prices substantially or discontinue service temporarily during the transition to full facilities-based competition.<sup>43</sup>

54. Fourth, ILECs can benefit in several ways by withholding UNEs entirely or otherwise making them so costly that CLECs are compelled to terminate their operations. Obviously, when they drive their retail competitors from the market altogether or from segments of the market, ILECs with retail pricing flexibility enjoy expanded freedom to raise prices and thereby increase profit. Even when transient retail rate regulation temporarily precludes price increases, an ILEC can be certain to secure the most profitable accounts (often those of business customers) by raising its rivals' costs to the point where rivals cannot economically compete for these accounts. In addition, by making it prohibitively costly for CLECs to supply voice services, ILECs can establish themselves as the exclusive providers of the bundles of voice, data, and video services that many customers value highly. In doing so, ILECs can secure the substantial revenue that these bundled offerings command. By driving competing suppliers of basic local exchange and exchange access service from the market, ILECs also can avoid losing universal service support.<sup>44</sup>

55. In summary, neither resale based competition nor competition based upon negotiated UNE prices can be relied upon to drive retail prices to competitive levels. Consequently, efficient CLECs that are denied regulated access to UNEs can only be expected to eliminate an ILEC's market power (and thus forbearance only is appropriate) when CLECs can serve all relevant customers economically either by securing UNEs at competitive rates from non-ILECs or by using their own facilities exclusively.

---

<sup>43</sup> Because GCI presently serves nearly 70% of its telephone customers via loops supplied by ACS, GCI would be particularly vulnerable to the substantial increase in UNE prices ACS would impose (or the limited supply of UNEs ACS would offer) if forbearance were implemented in Anchorage. High UNE prices and limited UNE supply could force GCI to discontinue facilities-based service to many of its customers. In addition to seriously damaging GCI's reputation, such service terminations would truncate valuable revenue streams that GCI is employing to finance the transitioning of many customers to full facilities-based operation. (See the Declaration of Gina Borland.) These strategic considerations may help to explain the timing of ACS' premature call for forbearance.

<sup>44</sup> 47 CFR 54.307(a) states "A competitive eligible telecommunications carrier shall receive universal service support to the extent that [it] captures the subscriber lines of an incumbent local exchange carrier (LEC) or serves new subscriber lines in the incumbent LEC's service area."

**5. The Reasonably Efficient Competitor Standard.**

56. The Commission has determined that the critical question in assessing whether a CLEC can operate economically without access to UNEs (and therefore whether CLECs would be able to eliminate ILEC market power if they were denied access to UNEs) is “whether lack of access to an incumbent LEC network element poses a barrier or barriers to entry ... that are likely to make entry into a market uneconomic ... [by] a reasonably efficient competitor.” [*TRO Remand*, ¶22] The Commission also notes that “In analyzing entry from the perspective of the reasonably efficient competitor, we do not attach weight to the individualized circumstances of the actual requesting carrier.” [*TRO Remand*, ¶26]

57. The use of this “reasonably efficient competitor” standard is appropriate for at least three important reasons. First, case-by-case analyses require substantial resources to implement, and so would be unduly burdensome for the Commission.

58. Second, the reasonably efficient competitor standard provides appropriate incentives to CLECs. If this standard is not employed, a CLEC might be afforded ongoing regulated access to UNEs simply because it is inefficient in operating without such access. Furthermore, if the standard is not employed, a CLEC that has put forth exceptional effort to enable economic operation without UNEs in one geographic region might be required to operate without regulated access to UNEs in other regions, even though such operation is substantially more costly in the other regions. Such a policy would discourage a CLEC from employing its own facilities exclusively to provide service in any portion of its operating territory until it is highly capable of doing the same throughout its operating territory. Such a policy would thereby hinder the development of full facilities-based competition, which is contrary to the public interest.

59. Third, the reasonably efficient competitor standard limits undue reliance on duopoly wholesale markets. Even if an exceptionally efficient CLEC could operate economically without regulated access to UNEs, other (reasonably efficient) CLECs may not be able to do so. Consequently, the ILEC and the exceptionally efficient CLEC may be the only firms that are able to supply UNEs to other CLECs. Although such duopoly supply is preferable to monopoly supply, duopolies often fail to deliver the vibrant competition that ensures competitive prices.<sup>45</sup>

---

<sup>45</sup> In assessing the UK’s experience with duopoly competition in its telecommunications industry, Armstrong et al. (1994, pp. 240-241) conclude “... the duopoly policy has been detrimental to the development of competition. ... [The] duopoly policy ... acted to preserve the essentially monopolistic

The reasonably efficient competitor standard helps to ensure that entry into relevant wholesale markets is economic for all reasonably efficient CLECs, and thereby helps to ensure that the competitive pressure required to drive input prices to efficient cost levels will be present on an ongoing basis.

60. At least in regions where GCI can reasonably employ its cable plant to supply relevant services, GCI's (incremental) costs of providing these services may be lower than the corresponding costs of reasonably efficient competitors that do not have established cable networks. Consequently, although it may be economic for GCI to serve some customers in relevant geographic markets in Anchorage, such service may be uneconomic for a reasonably efficient competitor.

61. In summary, the reasonably efficient competitor standard helps to conserve scarce Commission resources, provides appropriate incentives for CLEC investment, and can help to avoid undue reliance on duopoly wholesale markets. Consequently, as the Commission has determined, the reasonably efficient competitor standard is the appropriate standard to employ in determining whether forbearance from unbundling obligations is in the public interest.

#### **6. Balancing the Benefits and Costs of Forbearance.**

62. Unbundling is not a costless process. Consequently, timely forbearance has its benefits. However, premature forbearance can impose substantial costs. Appropriate forbearance policy must balance carefully the benefits of timely forbearance against the costs of premature forbearance.

##### **A. The Benefits of Timely Forbearance.**

63. Timely forbearance can provide at least three important benefits. First, timely forbearance can enhance incentives for ILEC investment in settings where ILECs are not undertaking efficient investment for fear of being required to make the investment available to competitors at non-compensatory rates. Of course, where appropriate, exemptions from

---

character of the old system in the core area of network competition. Neither did the duopoly policy enhance the prospects for competition in the longer term." Newbery (1999, p. 324) provides corroborating evidence, noting sharp increases in productivity only after the termination of the duopoly policy. Based on experience in the U.S. cellular industry, Parker and Röller (1997, p. 321) conclude "We find a need for public concern, as the duopolistic industry structure generally appears to be significantly more collusive than a noncooperative duopoly. The evidence suggests that cellular prices are significantly above competitive levels."

unbundling requirements for new ILEC investment can alleviate this concern without incurring the costs of more widespread premature forbearance. Furthermore, TELRIC rates are intended to be compensatory for an efficient ILEC, and so will not be confiscatory for an efficient ILEC *when the rates are designed properly*.<sup>46</sup>

64. Second, timely forbearance can eliminate some of the costs associated with determining and implementing appropriate regulated UNE rates. In practice, these regulatory costs can be substantial.<sup>47</sup> However, corresponding costs typically arise even in unregulated settings. Parties to commercial transactions routinely incur nontrivial costs associated with negotiating, monitoring, and enforcing formal agreements.

65. Third, timely forbearance (with appropriate transition periods) can speed the transition from regulation to competition in settings where CLECs have entered the market and gained market share using UNEs but continue to use UNEs even though they are presently able to compete profitably using their own facilities exclusively. It is important to note in this regard that GCI is transitioning customers to its own facilities rapidly even though no regulation compels it to do so. GCI is anxious to end its dependence on its retail rival, and so is working diligently to implement full facilities-based operation to the extent possible. [Declarations of Gina Borland, Richard Dowling, and Gary Haynes] Even ACS acknowledges that “GCI is aggressively migrating its customers off of ACS’ network and onto its own switched cable telephony network.” [ACS *Petition*, p. 31] Consequently, this potential benefit of timely forbearance appears to be of limited relevance in the present proceeding.<sup>48</sup>

---

<sup>46</sup> If ACS truly believes it faces “below cost” UNE rates [ACS *Petition*, p. 41], forbearance is not the appropriate remedy for this perceived problem. As the Commission has noted, “If rules other than those implementing section 251(d)(2) are impeding the development of competition – either by preventing competitive entry or by fostering excessive reliance on UNEs – parties should seek redress of the problematic rules themselves, rather than attempt to tilt the unbundling framework to account for the asserted deficiency.” [TRO *Remand*, ¶38] It is notable that the latest UNE rates were set in an arbitration conducted following and in light of the Commission’s *TRO Order*, in which the Commission clarified its rules regarding appropriate depreciation rates and capital costs.

<sup>47</sup> The Commission observes that “unbundling can create disincentives for incumbent LECs and competitive LECs to deploy innovative services and facilities, and is an especially intrusive form of economic regulation – one that is among the most difficult to administer.” [TRO *Remand*, ¶36]

<sup>48</sup> The Declaration of Richard Dowling reviews the substantial progress GCI has made in transitioning to full facilities-based operation despite the many impediments it faces. Some of these impediments are reviewed in the Declarations of Blaine Brown, Richard Dowling, and Gary Haynes.

**B. The Costs of Premature Forbearance.**

66. Premature forbearance can introduce at least five important costs. First, premature forbearance can deprive some customers of the low prices they presently enjoy. *This will be the case when the denial of regulated access to UNEs renders CLECs unable to serve some of their customers economically within a commercially reasonable period of time.* In areas where GCI's cable plant is not yet capable of delivering telephone service and for services that GCI cannot deliver economically over its cable or fiber plant, GCI will be unable to serve customers economically within a commercially reasonable period of time. The Declaration of Gary Haynes explains that GCI cannot deliver telephony service over its cable plant until relevant nodes are upgraded. The Declarations of Gary Haynes and Lisa Wurts further demonstrate that even after nodes are upgraded, GCI will be unable to provide telephony service over its cable facilities to some customers for a considerable period of time because of the need to upgrade drops. The Declaration of Gary Haynes further states that GCI cannot employ its cable plant to provide high capacity services to some business customers. Furthermore, the Declaration of William Zarakas demonstrates that GCI cannot serve any but the largest enterprise customers economically using its fiber plant. Consequently, under forbearance, GCI would be compelled either to terminate service to many customers or to serve them through resale or higher priced UNEs. These customers would be denied the lower prices that market competition can secure.<sup>49</sup>

67. Second, premature forbearance can reduce relevant supply elasticities by discouraging CLECs from entering the industry or expanding their operations. Premature forbearance allows ILECs to raise UNE prices unduly (or simply decline to supply UNEs and force CLECs to employ resale) and thereby render CLEC operation less profitable (and perhaps entirely unprofitable). Consumers are harmed when limited CLEC operation reduces the intensity of market competition and enables ILECs to exercise market power.

68. Third, premature forbearance can deter full facilities-based competition. If access to UNEs at regulated rates is withdrawn ubiquitously as soon as a CLEC demonstrates some ability to operate without UNEs in selected geographic regions, CLECs will rationally refrain from demonstrating their ability to serve any customers using their own facilities exclusively. Consumers are harmed when full facilities-based investment is deterred by premature forbearance.

---

<sup>49</sup> Such termination also forces affected customers to bear the costs associated with switching suppliers.

69. Fourth, premature forbearance can reduce CLEC investment and induce the adoption of inefficient production techniques. For example, forbearance from access to UNEs could force CLECs to resell ILEC services rather than use their own switch – which is the platform for providing many innovative enhancements as well as customer conveniences such as location portability – combined with a UNE leased from the ILEC.<sup>50</sup> Industry innovation and the intensity of industry competition can be expected to decline if facilities-based competition is replaced by resale competition, in part because a CLEC that does not provide its own switching cannot provide new service features or control the bundling of those features. The Declaration of Dana Tindall explains how GCI's use of its own switch allowed it to introduce innovative services that it could not have provided using resale.

70. Fifth, premature forbearance can reduce the intensity of long-term industry competition by tarnishing the image of CLECs who are forced to terminate service to customers or raise their prices dramatically. When consumers are inconvenienced, they typically attribute the inconvenience to their current supplier. If a CLEC's brand image is tarnished by inappropriate changes in regulatory policy, the CLEC's long-term ability to limit the market power of incumbent suppliers may be jeopardized.

### **C. Balancing Benefits and Costs.**

71. In practice, it generally is difficult to predict perfectly the level of competitive discipline CLECs will be able to impose if they are denied regulated access to UNEs. Consequently, it can be difficult to determine precisely whether forbearance is appropriate in a relevant market at any given point in time. In designing forbearance policy, the potential benefits of timely forbearance and the potential costs of premature forbearance must be balanced carefully to make appropriate forbearance decisions.

72. The reasonably efficient competitor standard is an important element of this balancing. This standard will conserve scarce Commission resources, promote valuable incentives, and limit undue reliance on duopoly wholesale markets, for the reasons identified in section 5. Evidence that even an exceptionally efficient competitor would be impaired if it were denied regulated

---

<sup>50</sup> The Declaration of Gina Borland explains why forbearance from unbundling obligations in Alaska would slow the development of full facilities-based operation by compelling GCI to divert its present focus on transitioning customers to full facilities-based service to transitioning customers to resale-based service.

access to UNEs can constitute compelling evidence that a reasonably efficient competitor also would be impaired.

73. In seeking forbearance, ILECs must demonstrate that they would possess no market power if reasonably efficient CLECs were denied regulated access to UNEs. Importantly, such demonstration requires showing an inability to raise prices above competitive levels both in relevant retail markets and in relevant wholesale markets.<sup>51</sup>

74. Industry uncertainty would be reduced (and thus incentives for industry participation and investment would be enhanced) if the basic principles that will govern forbearance decisions were specified clearly far in advance of actual forbearance. Reasonable transition periods should be adopted as these principles are formulated and implemented.<sup>52</sup> Reasonable transition periods following the clear enunciation of forbearance principles (which have not yet been formulated) can help to limit some of the costs of premature forbearance identified above.

#### **7. Forbearance in Anchorage is Contrary to the Public Interest.**

75. A careful balancing of the benefits of timely forbearance and the costs of premature forbearance makes it clear that forbearance presently is inappropriate in Anchorage. As noted above, a principal potential benefit of timely forbearance is of limited importance in the present setting. GCI does not need to be compelled to pursue full facilities-based operation. ACS observes that "GCI is aggressively migrating its customers off of ACS' network and onto its own switched cable telephony network" in the absence of any regulatory mandate to do so. [ACS *Petition*, p. 31] The Declaration of Richard Dowling notes the substantial progress GCI has made in this regard, despite the many obstacles it has encountered. The Declaration of William Zarakas supports ACS' observation that GCI is aggressive pursuing full facilities-based operation where such operation is economic. Thus, GCI appears to need no regulatory prodding to induce it to pursue full facilities-based operation as such operation becomes economic.

76. While the benefits of forbearance in Anchorage are limited, the corresponding costs are pronounced. ACS would enjoy market power in many relevant markets if CLECs were denied

---

<sup>51</sup> As explained more fully in section 8, ACS' appeal for forbearance fails to recognize adequately its wholesale market power.

<sup>52</sup> Reasonable transition periods need not be uniform throughout the nation. As explained in the Declarations of Gina Borland and Gary Haynes, the transition to full facilities-based operation can be slowed considerably by weather conditions of the sort that prevail in Anchorage.

access to UNEs at regulated rates in Anchorage. ACS' market power would stem from its status as the dominant supplier of key inputs (e.g., loops). As noted above, more than 80% of the switched lines in service in Anchorage employ loops supplied by ACS,<sup>53</sup> and the potential for additional non-ACS supply within a commercially reasonable period of time is limited. Under forbearance, ACS could and would employ its control over key inputs to raise its rival's costs, and thereby compel its rivals either to stop serving customers or to raise retail prices substantially. The rosy picture of retail competition that ACS paints would change rapidly if ACS were permitted to employ its wholesale market power to seriously undermine the operations of its retail competitors.

77. The fact that GCI has transitioned some of its customers to its own facilities does not imply that it can economically transition all of its customers to its own facilities. Although GCI's present plan to transition additional customers to full facilities-based operation may be economic, GCI cannot presently employ such operation to serve many residential customers economically. Nor can GCI economically employ its own facilities exclusively to serve medium and large business customers. Furthermore, the fact that GCI plans to transition more customers to its own facilities over a reasonable time horizon does not imply that GCI can economically effect a more rapid transition. For the reasons noted in section 3C and explained in more detail in the Declarations of Richard Dowling and Gary Haynes, irrationally rapid transition may not even be feasible and certainly can be far more costly than the timely transition that GCI plans to undertake in the coming months. As described in Ms. Borland's declaration, even if feasible, such a transition would likely cause significant customer disruption and competitive harm to GCI.

78. Forbearance in Anchorage also would create detrimental incentives for CLECs throughout the United States. If GCI is punished for demonstrating that it can supply service to some customers using solely its own facilities (and announcing plans to transition more customers to its own facilities as it becomes economic to do so), CLECs elsewhere will realize that pronounced facilities-based operation and timely transitioning of customers to one's own facilities is unwise. To provide the appropriate incentives to all CLECs, it is important that exemplary CLECs not be punished for leading the way toward full facilities-based competition.

---

<sup>53</sup> See the Declaration of William Zarakas.

79. In summary, the costs of forbearance in Anchorage outweigh any potential benefits. Forbearance would leave retail customers vulnerable to ACS' market power, produce *supracompetitive* wholesale and retail prices, and limit incentives for full facilities-based competition. Consequently, forbearance from unbundling obligations in Anchorage is contrary to the public interest.

**8. Rebuttal Arguments.**

80. I now identify some of the many errors in the arguments ACS employs in its petition for forbearance from unbundling obligations in Anchorage.

**A. GCI would be impaired without regulated access to UNEs.**

81. ACS claims that GCI "is not impaired without access to UNEs" [*ACS Petition*, p. 3]. The Declaration of William Zarakas demonstrates that this claim is incorrect. If GCI were denied access to UNEs, GCI would be unable to serve many medium and large enterprise customers economically. GCI might also be unable to serve residential customers in MDUs economically. Furthermore, if GCI were abruptly compelled to rely on its own facilities exclusively, it likely would become physically impossible or economically infeasible for GCI to serve many of the residential customers that it presently plans to transition to full facilities-based operation in the near future.

82. Professor Shelanski contends that GCI's success in attracting retail customers "using exclusively or primarily its own facilities" makes "the case against impairment, and hence against unbundled access, an overwhelming one in the Anchorage Study Area" [*Shelanski Statement*, ¶5].<sup>54</sup> This contention is both superficial and incorrect for at least three reasons.

83. First, even when a CLEC operates "primarily" using its own facilities in one product and geographic market, it may be impaired if it is denied regulated access to UNEs in other product and geographic markets. Despite its extensive facilities-based operations, nearly 70% of the switched lines that GCI provides in Anchorage employ loops supplied by ACS.<sup>55</sup> Forbearance would allow ACS to raise dramatically the prices of these essential inputs or even make the

---

<sup>54</sup> *Statement of Howard A. Shelanski in Support of Petition of ACS of Anchorage, Inc. for Forbearance From Sections 251(c)(3) and 252(d)(1)*, WC Docket No. 05-281, September 30, 2005.

<sup>55</sup> See the Declaration of William Zarakas.